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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of

Policies and Rules Concerning Toll Fraud

CC Docket No. 93-292

**COMMENTS
OF THE
AMERICAN PETROLEUM INSTITUTE**

THE AMERICAN PETROLEUM INSTITUTE

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Dated: January 14, 1994

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SUMMARY

The proposal in the NPRM to reallocate liability for remote access or CPE-based toll fraud falls short in two major respects. First, it fails to ensure a realistic and equitable apportionment of liability for toll fraud losses. Second, it fails to provide appropriate incentives for all parties to take all reasonable steps to prevent the occurrence and to minimize the extent of fraud.

API proposes an allocation of liability that addresses these problems. Fundamentally, the Commission must provide carriers with a legal incentive to mitigate fraud by shifting liability to the carriers when they fail to act promptly to detect, and report to the customer, the occurrence of toll fraud. Users should be liable for fraudulent calls only where their negligence is responsible for the fraud or when they are aware of ongoing fraud. Equipment providers, equipment maintenance entities and carriers should be liable where the existence or continuation of fraud is attributable to their negligence or failure to mitigate. The Commission should take all reasonable steps to ensure that these potentially responsible parties are not in a position to avoid liability for toll fraud losses attributable to their negligence.

Central to API's proposal is the principle that carriers should not profit from fraudulent calls. Allowing carriers to profit from the misfortune of their customers is not only unfair, it provides carriers with an incentive to allow ongoing incidents of fraud to continue.

API supports the proposal to obligate carriers and equipment manufacturers to warn their customers of the risk of fraud related to the use of particular services or equipment. In addition, equipment manufacturers should be subject to a continuing obligation to investigate how their equipment can be exploited to accommodate toll fraud, as well as an obligation to provide detailed information to their customers on how such fraud occurs and how it can be prevented. To the extent a toll fraud incident is attributable to a software failure, the manufacturer should be under an obligation to cure the defect at no cost to the user. API supports the proposed requirement that fraud monitoring and detection capabilities be made a part of the carriers' basic service offerings. Users must not be required to subscribe to carrier-provided toll fraud insurance programs; the obligation to monitor and detect toll fraud should apply to all customers. Third party billing not preauthorized by the billed party should not be allowed.

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To the Commission:

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The American Petroleum Institute ("API"), by its attorneys, hereby respectfully submits its Comments in response to the Notice of Proposed Rule Making ("NPRM") adopted by the Federal Communications Commission ("FCC" or "Commission") on November 10, 1993.^{1/}

I. PRELIMINARY STATEMENT

1. API is a national trade association representing approximately 300 companies involved in all phases of the petroleum and natural gas industries, including exploration, production, refining, marketing, and transportation of petroleum, petroleum products and natural gas. Among its many activities, API acts on behalf of its members as

^{1/} Notice of Proposed Rule Making, 58 Fed. Reg. 65153 (December 13, 1993).

spokesperson before federal and state regulatory agencies. The API Telecommunications Committee is one of the standing committees of the organization's Information Systems Committee. The Telecommunications Committee evaluates and develops responses to state and federal proposals affecting telecommunications facilities used in the oil and gas industries.

2. API has long been concerned with the problem of toll fraud. Most, if not all, API member companies have been victims of toll fraud. In November of 1992, API submitted comments in response to the FCC's en banc hearing on toll fraud. Those comments, among other things, urged the Commission to commence a rulemaking proceeding aimed at reallocating responsibility for toll fraud. API is encouraged by the Commission's decision to commence such a proceeding and API greatly appreciates this opportunity to present its views based on the experiences of its members.

II. DISCUSSION

3. Toll fraud is a multibillion dollar a year problem affecting the telecommunications industry. As large users of telecommunications services, API members have been particularly affected by the problem of customer premises

equipment ("CPE")^{2/} or remote-access based toll fraud. The impact of such fraud on users has been severe.^{3/} Because perpetrators of toll fraud are generally not apprehended, and because interexchange carrier ("IXC") tariffs hold the customer responsible for toll fraud losses, it is the user community that has been forced to bear the brunt of financial loss due to toll fraud.

A. The Proposed Changes in Toll Fraud Liability Are Inadequate and Will Not Provide Sufficient Economic and Legal Incentives for All Parties to Prevent or Mitigate Toll Fraud

4. The current liability scheme for toll fraud losses places full responsibility on the user. It is unjust and inimical to the public interest. API applauds the Commission's intent as expressed in the NPRM to allocate responsibility for toll fraud amongst users, carriers and equipment manufacturers in accordance with their ability to detect and prevent fraud. Allocating a portion of liability for toll fraud to the carriers and equipment manufacturers

^{2/} CPE encompasses private branch exchanges ("PBXs"), other switching systems, and other equipment attached by the user to the public switched telephone network.

^{3/} For example, a "White Paper" prepared by API for the internal use of API members describes several incidents of toll fraud involving API member companies. The losses attributed to these surveyed incidents of fraud ranged from \$10,000 to \$100,000 per incident.

will not only relieve users of their unjustified burden,^{4/} it will provide carriers and manufacturers with a genuine incentive to develop improved network and equipment security measures. It is through such improvements that fraud is likely to be reduced. By way of example, the \$50 cap on calling card fraud provided the carriers with the legal and economic incentives to assume responsibility for mitigating such fraud. The carriers instituted steps to detect calling patterns and limit the ability of unauthorized users to utilize compromised calling card numbers.

5. The NPRM proposes a comparative negligence approach to liability for CPE-based toll fraud, whereby the various parties in a position to detect or prevent the fraud would assume a certain portion of liability for fraud based on their failure to meet certain defined responsibilities. Under this approach, the Commission would define the specific responsibilities of the CPE owner to secure the equipment, the equipment manufacturer to warn of toll fraud risks associated with features of the equipment, and the carrier to offer detection and prevention programs.

^{4/} As discussed in API's en banc Comments, toll fraud cannot be eliminated by increased user security measures alone. There must be cooperation from all parties involved.

6. This approach fails to apportion responsibility for toll fraud losses in an equitable manner, and it fails to provide appropriate incentives for all parties to exert maximum efforts to prevent the occurrence and minimize the amount of such fraud. Under the proposed approach, the responsibilities and duties of equipment providers, CPE maintenance organizations and carriers are far too limited and are drawn far too narrowly. The equipment manufacturer's obligation needs to go beyond warning users of toll fraud risks. Equipment manufacturers should be under a continuing obligation to investigate how their equipment can be used to accommodate toll fraud, notify their customers of the discovery of all such methods, provide detailed information on how to prevent such fraud and, when necessary, correct equipment defects, preferably at nominal cost to the customer. Similarly, carrier responsibilities should go beyond the mere offering of detection and prevention programs. Carriers should be under an obligation to notify users as soon as the possibility of fraud is detected, irrespective of whether the customer subscribes to a toll fraud insurance program.

7. The proposals set out in the NPRM do not create sufficient economic incentives for parties (particularly carriers) to take all reasonable steps to prevent and

mitigate toll fraud. In this sense, the proposals in the NPRM carry forward the fundamental flaw in the current toll fraud liability scheme: the carriers who are in a position to detect toll fraud (and who can and do detect such fraud) have no legal or economic incentive to do so. Rather, the current liability scheme ensures that the carriers receive a significant windfall from all incidents of toll fraud: more minutes of use charged to the victimized customer at the applicable rate.

8. API proposes an approach to liability that will equitably allocate the risk of fraud amongst potentially responsible parties by providing appropriate incentives for all parties to take measures to prevent or minimize the extent of such fraud. API's proposal is based on three key principles:

- 1) Carriers should not profit from fraudulent calls.
- 2) Users should be liable for fraudulent calls only where their negligence is responsible for the fraud or when they are aware of ongoing fraud.

- 3) Legal duties should be structured to provide each party with a significant economic incentive to take all appropriate actions which they can reasonably take to prevent or mitigate toll fraud.

9. API's proposal involves a shift in liability at various points in time following commencement of a toll fraud incident. Liability would be shifted among the various parties that are in a position to either prevent or mitigate the fraud. Specifically, users should be fully responsible for fraud until such point as the carriers are reasonably capable of detecting such fraud, unless the fraud resulted directly from the negligence of other parties, including equipment manufacturers and maintenance organizations, as well as, in some instances, the carriers.^{5/} Where the fraud is attributable to the

^{5/} This discussion generally views a carrier as principally an interexchange or interLATA service provider. It is anticipated that carriers acting in this capacity will rarely be responsible for causing the fraud. However, where a single entity provides both the transport service and the equipment and maintenance support, its culpability for fraud is much more likely. In addition, apart from placing responsibility on a carrier for allowing fraud to occur, the phased approach to liability discussed herein recognizes the carrier's obligation to mitigate the extent of such fraud by preventing its continuation.

negligence of other parties, liability^{6/} should be shared by all negligent parties.^{7/} If no determination of negligence can be made, liability should be shared by all potentially responsible parties.

10. To provide carriers with an appropriate incentive to promptly detect fraud, API proposes that user liability initially be limited to a period of time ("Phase I") commencing with the initial breach of the user's system and terminating when the first of two events occur: (1) Four hours have elapsed; or (2) \$500 worth of unauthorized calls have been incurred.^{8/} If the carrier fails to notify the

^{6/} API recognizes that, because the Commission has no authority to impose monetary forfeiture penalties on equipment manufacturers or maintenance support organizations, when such parties' negligence is wholly or partially responsible for the fraud, users must rely principally on contractual or judicial remedies to obtain relief. One exception is where a single carrier provides both the transport service and the equipment and maintenance support. In such cases, the carrier should be required to assume responsibility for the entire amount of the fraud where there is no user negligence.

^{7/} API discusses the factors involved in making a determination of negligence in paragraph 14 below.

^{8/} Based on the experience of API member companies, the major carriers possess the ability to detect ongoing incidents of fraud on a real-time basis. API recognizes that there must be a detectable pattern of calls before fraud can be suspected or identified, and acknowledges that it would be unfair to hold a carrier fully liable for fraud that occurs during a reasonable predetection period. The precise period for which users should be liable must be keyed to the carrier's ability to identify calling patterns
(continued...)

user of the ongoing fraud prior to the end of Phase I, liability would then shift, in part, to the carrier. Specifically, the carrier would at this point be liable for 50% of the net cost of the provision of the fraudulent calls while the remaining 50% should be allocated among all negligent parties.

11. Carrier notification of an ongoing incident of fraud would not be deemed complete until the user has "acknowledged receipt" of such notification. Carriers should be required to continue attempts to personally notify an authorized representative of the customer until such contact is successfully made. If the carrier does not exert due diligence, it should be liable for all fraud that continues until notification is actually received. For example, leaving a message on voice mail early Saturday morning knowing the message may not be "received" for several days while the fraud continues is unreasonable. Of course, the user must be responsible for providing the carrier with sufficient information to promptly reach an appropriate individual with the notification.

^{8/}(...continued)
sufficient to trigger the fraud parameters set by the customer. Based on API's knowledge of carrier capabilities, the four hour/\$500 milestone is a reasonable demarcation point.

12. Once "Phase II" has ended (i.e., the user has acknowledged receipt of the notification), it is appropriate for liability to shift fully back to the user. At this point, the carrier has, for all intents and purposes, taken all the steps that it can reasonably take. The user must then direct that service be terminated, modify its CPE or take whatever other action is required to halt the fraud. Of course, where a carrier is directed by the user to take action required to terminate the fraud, and the carrier fails to take such action within a reasonable period of time, the carrier should be held liable for all fraudulent calls that continue subsequent to its receipt of the customer notification.

13. Carriers and customers would be free to arrange for the carrier to unilaterally terminate service upon the first suspicion of toll fraud. However, based on experience with instances of alleged calling card fraud, where fraud has been suspected based on legitimate use, carriers should not be permitted to unilaterally terminate service absent preauthorization from the customer. Notice to the customer of fraud should be the standard procedure.

14. Liability during "Phase I," 50% of the liability not attributable to the carrier during Phase II, and all

losses incurred after carrier notification is received and acknowledged must be based on negligence as proposed in the NPRM.^{2/} Negligence may be determined pursuant to either alternative dispute resolution ("ADR") or a Commission proceeding. It may also be addressed in the courts. A finding of user negligence should be based on a determination that the user failed to take reasonable security precautions. Such precautions may include measures such as making passwords as long as possible and changing them at relatively frequent yet irregular intervals, changing all default passwords, deactivating codes of former employees, restricting remote access during non-business hours for employees who do not require such access, and implementing internal procedures requiring PBX operators to verify the identity of any caller seeking connection to an outbound line. Reasonable security precautions should not entail undue expense. As technology changes, and fraud is perpetrated through different or more sophisticated approaches, more vigorous user security measures would be expected.

15. API further proposes that a perverse incentive for toll fraud be removed by limiting liability for toll fraud

^{2/} The 50% of liability attributable to the carrier during Phase II is not based on negligence; rather, it constitutes a reasonable "mitigation incentive."

to the carrier's "cost" of providing the service.^{10/} Absent such a limitation, carriers have no economic incentive to curtail fraud. As long as an incident of fraud continues, the carrier's profits increase. While the carriers may maintain such a measure is unwarranted or unfair, it is egregiously unfair, as well as unsound public policy, to continue to allow carriers to profit from the misfortune of their customers.

B. Additional Carrier Obligations Are Warranted

16. Apart from eliminating "profit" from toll fraud and imposing a portion of potential toll fraud losses on the carrier to encourage effective mitigation, the Commission should require carriers to undertake other measures looking toward the prevention or minimization of toll fraud losses. Specifically, fraud monitoring and detection capabilities should be an integral part of their service offerings, not optional features available only at an additional charge. Carriers should also be required to warn customers of the risks of using certain carrier services such as Direct Inward System Access ("DISA") services or deploying services

^{10/} API recognizes that administration of this requirement may be difficult. As an alternative, the Commission may wish to consider requesting a uniform discount per call (e.g., 20-30% of the tariffed cost).

in certain configurations. Thus, API supports the Commission's tentative conclusion that carriers must be obligated to warn customers of risks of using carrier services. Carriers should also be required to notify their customers when they make a network modification that may affect the prevention or detection of toll fraud.

17. The NPRM requests comment on the efficacy of the so-called "fraud insurance" offerings (i.e., AT&T NetProtect, MCI Detect, SprintGuard) of the major IXCs. These offerings are flawed, based on an erroneous assumption, and should not provide the basis for any solution to the toll fraud problem. Fundamentally, the concept of fraud insurance is based on the assumption that the user is at fault and consequently liable for all CPE-based toll fraud. However, as discussed above, many parties share responsibility for the occurrence and continuation of such fraud. Fraud insurance that requires the user to bear the full cost of dealing with such fraud therefore bears no relation to an appropriate division of responsibilities and assignment of legal duties. In addition, due to the large number of coverage exclusions, limitations on eligibility and qualifying conditions contained in these insurance offerings, they are largely inadequate and rarely serve their intended purposes.

18. API does not suggest that fraud insurance is entirely without benefit, but only that it should not form the basis of the Commission's fraud protection policy. The indemnification aspects of fraud insurance serve a useful purpose. Some users may desire "full coverage" to minimize any potential liability from incidents of toll fraud. This option should be available. However, the obligations of carriers to detect and mitigate incidents of toll fraud should not be contingent on the purchase of carrier toll fraud "insurance". Ultimately, the carriers need to change their outlook on communications security issues. Security should be viewed as a cost of doing business rather than an opportunity to sell additional products and services.

C. Equipment Manufacturer Responsibilities Must Be Expanded

19. Manufacturers of CPE should also be required to assume some responsibility for the prevention of fraud. API supports the Commission's proposal to amend part 68 of its rules to require equipment manufacturers to provide warnings regarding the potential risk of toll fraud and the consequent liability exposure associated with use of the equipment. However, this requirement does not go far enough. CPE manufacturers should be under a continuing

obligation to investigate how their equipment can be used to accommodate toll fraud, notify their customers of the discovery of all such methods and provide detailed information on how to prevent such fraud. This obligation should be made retroactive as well. In addition, manufacturers should be required to make software upgrades that cure fraud-enabling software defects or shortcomings available to all customers at nominal cost. The same principle should be applied to similar deficiencies in hardware.

20. In general, these deficiencies should be considered analogous to problems in cars and other products that warrant manufacturer "recalls." The CPE provider should be obligated to correct these deficiencies without charge. API is concerned with the practice of some CPE providers of characterizing such corrections as "new releases" or "upgrades," and charging customers for the corrections. This is a shoddy and patently unfair practice. CPE providers should be under a legal duty to correct known deficiencies in software or hardware that can potentially subject customers to thousands of dollars in liability.^{11/}

^{11/} However, if a software upgrade or hardware change entails a comprehensive software rewrite, change in operating system software or complete redesign, a reasonable charge may be appropriate.

D. Equipment Maintenance Providers Are Often at Fault.

21. Although the NPRM recognizes that parties other than carriers and equipment manufacturers may play a role in toll fraud, the Commission should explicitly recognize the critical role of the CPE maintenance entity. In many instances, this party is not the CPE vendor or manufacturer. This entity often has access to the CPE through remote maintenance ports, and it thereby controls a pathway frequently utilized by fraud perpetrators to access a company's CPE. Fraud perpetrators have been able to "hack" their way into a system via a remote maintenance port or, in many instances, have been given the password by the maintenance entity by impersonating the authorized user. The latter instance is particularly egregious because the password is under the sole control of the maintenance entity.

22. Under the shared liability approach suggested above, the maintenance entity would be responsible at least in part for fraud resulting from its negligence. However, under the terms of many maintenance agreements, maintenance entities have disclaimed responsibility for any losses due to fraud. The Commission should make clear that all

maintenance contracts that disavow the maintenance entity's liability for fraud are per se unreasonable.

E. The Commission Should Adopt the Policy of Allowing Third Party Billing Only When Expressly Authorized by the Billed Customer

23. The matter of third party billing abuse is raised in the NPRM and should be addressed by the Commission. A number of member companies have investigated incidents of third party billing abuses and have found the problem more insidious, though less dramatic, than PBX-based toll fraud. Losses of \$100-\$300 per month per location are not unusual, but detection requires meticulous reviews of monthly bills. An audit of several month's bills conducted by one member company indicated a constant level of abuse at major locations.

24. This company's investigation revealed the following practice applies: unless a business line (trunk) is not expressly "flagged" in the serving LEC's data base, all third party billing to that line is "authorized." The data base reveals whether the line (number) is "blocked" or not for purposes of third party billing. As new trunks are added, the customer must affirmatively request that the trunk (line) not be eligible for third party billing. For

large companies with multiple locations, this is a burdensome task. In regard to billing disputes, the member company's review indicated that business customers are held accountable for third party billed calls if they have not "blocked" their lines. Conversely, residential customers that protest third party billing charges are often accommodated.

25. Based on this company's review, the carriers' data base verification procedures for third party billing are inconsistent, at best. One major interexchange carrier bills the call to the number if it cannot verify that the number is not blocked. Another major interexchange carrier will not bill the call unless it can verify that the number accepts third party billing. Moreover, representatives of one Bell Operating Company advised that small independent telephone companies do not attempt to verify in every instance whether a number does or does not accept third party billing.

26. Structuring the data base and blocking obligations to encourage third party billing in an era when calling cards are widely available, even for consumers, makes little sense. All customers should have the option to control third party billing in an administratively efficient manner.

The Commission is urged therefore to adopt the following as a uniform standard for third party billing: unless a customer expressly authorizes that a line or location can receive third party billed calls, third party billing should not be allowed. That is, the "default" should be that the third party billing is not accepted. Other than changing the present "default" posture, the ongoing administration of the data bases should not be made more difficult.

F. Other Questions Related to Toll Fraud Can Be Addressed in This Proceeding.

27. The NPRM raises the issue of whether the Commission should encourage the enactment of legislation that would (1) clearly define and penalize toll fraud as a criminal activity, and (2) provide law enforcement authorities with the tools they require to track and prosecute perpetrators of toll fraud. Although API believes that the solution to the toll fraud problem lies in an appropriate allocation of legal responsibility that creates economic incentives on the part of carriers, users, manufacturers, and maintenance entities to take actions to prevent or minimize toll fraud, API would support the enactment of any such legislation directed at criminalization and enforcement. In this regard, the Commission is encouraged to take appropriate measures in

support of any such legislation, including, if necessary, the drafting of legislation.

28. The matter of cellular toll fraud is also raised in the NPRM. Cellular toll fraud entails additional concerns and issues which the Commission should address. Similar to the proposed changes in CPE-based toll fraud, the legal and economic incentives must be allocated among all potentially responsible parties to resolve the matter.

WHEREFORE, THE PREMISES CONSIDERED, the American Petroleum Institute respectfully requests that the Federal Communications Commission take action in a manner consistent with the views expressed herein.

Respectfully submitted,

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